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Reserve
Oil and Gas Company
Annual Report
1974

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Newton T. Bass, *Apple Valley*
Chairman of the Board, Emeritus

John R. McMillan, *Los Angeles*
Chairman of the Board and Chief Executive Officer

Paul D. Meadows, *Denver*
President and Chief Operating Officer

Joseph A. Ball, *Long Beach*
Partner, Ball, Hunt, Hart, Brown and Baerwitz, Attorneys

Llewellyn Bixby, Jr., *Long Beach*
President, Bixby Land Company

Walter E. Cramer, Jr., *Apple Valley*
Vice President

Cortlandt S. Dietler, *Denver*
President, Western Crude Oil, Inc.

Harold F. Green, *Los Angeles*
Senior Vice President

Malcolm McDuffie, *Los Angeles*
President, Mohawk Petroleum Corporation, Inc.

Howard C. Pyle, *Los Angeles*
Petroleum Investments

B. J. Westlund, *Lake Oswego, Oregon*
Retired Businessman

Officers

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Chairman of the Board, Emeritus

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Chairman of the Board and Chief Executive Officer

Paul D. Meadows, *Denver*
President and Chief Operating Officer

Harold F. Green, *Los Angeles*
Senior Vice President

Walter E. Cramer, Jr., *Apple Valley*
Vice President

William H. LeRoy, *Denver*
Vice President—Exploration

Marshall C. Turner, *Denver*
Vice President—Operations

Robert E. Aberley, *Apple Valley*
Vice President and Treasurer

J. Edouard Michaud, *Denver*
Vice President—Planning and Development

Thomas L. Deen, *Los Angeles*
Secretary

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m., on May 5, 1975, in the Assembly Room, 3rd floor, 550 South Flower Street, Los Angeles, California. The notice of meeting and proxy statement will be mailed to Shareholders in advance of the meeting.

Reserve Oil and Gas Company

Executive Offices:
550 South Flower Street
Los Angeles, CA 90017

The Cover

The cover graphic symbolizes, by the drilling bit *at upper left,* the Company's oil and gas exploration and development activity; *clockwise,* by the pipeline valve, Western Crude's oil purchasing, transporting and marketing activities, both domestic and foreign; by the maple leaf, Canadian Reserve's oil and gas activities; by the scenic montage, the land development business of the Company; and by the Indian head, Mohawk's gasoline and petroleum product refining and marketing.

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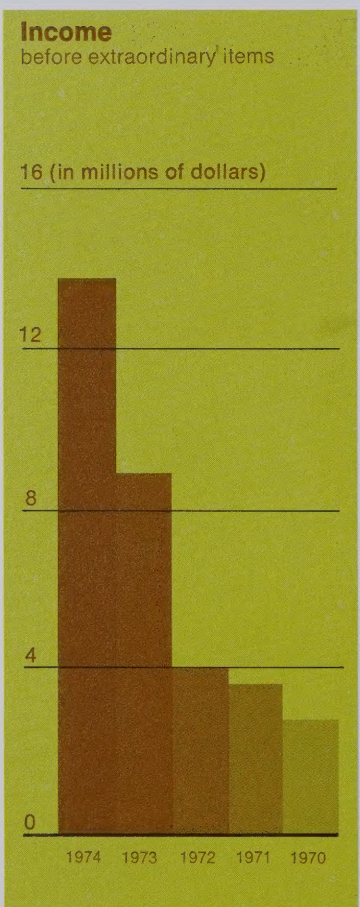
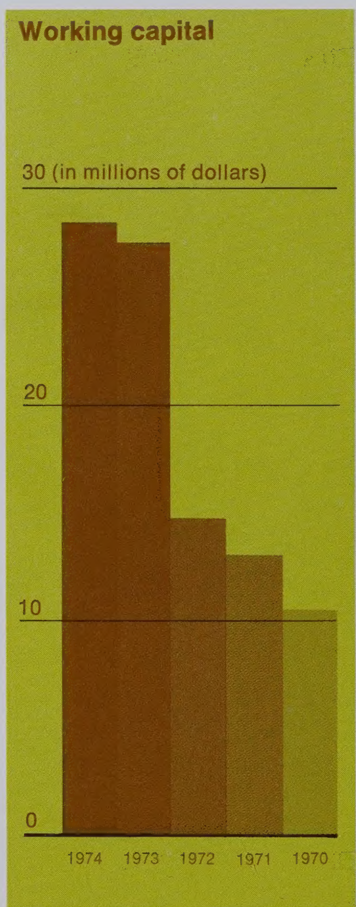
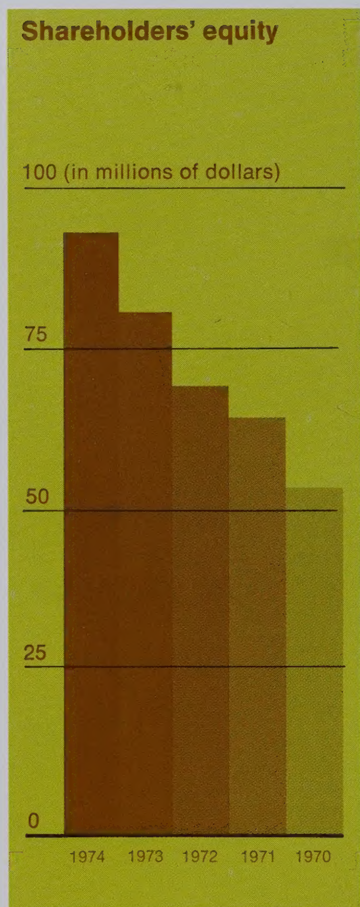
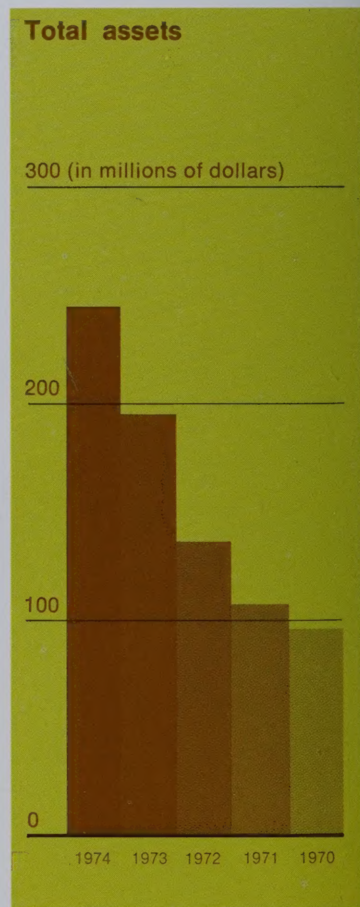
Financial and Operating Highlights

Financial	1974	1973
Total revenues	$724,721,000	$406,007,000
Income before extraordinary credits	13,677,000	8,768,000
Per common share	1.08	.68
Extraordinary credits	—	2,000,000
Per common share	—	.16
Net income	13,677,000	10,768,000
Per common share	1.08	.84
Common stock cash dividends	1,228,000	—
Per common share	.10	—
Working capital	28,296,000	27,491,000
Shareholders' equity	93,388,000	81,354,000
Total assets	241,242,000	196,543,000
Capital expenditures and investments	23,138,000	15,712,000
Operating		
Crude oil and natural gas liquids production, barrels per day	9,538	10,153
Natural gas sales, Mcf per day	33,439	32,226
Crude oil processed, barrels per day	20,160	16,102
Crude oil sales (net), barrels per day	157,260	154,441
Petroleum product sales, barrels per day	37,219	27,196









The management of the Corporation welcomes all those who became shareholders since our last report. In line with our policy of keeping shareholders completely informed of the Company's plans and activities, we shall be happy to provide copies of past annual and quarterly reports. If you are interested, please address your request to the Secretary of the Company.

From the Chairman

Reserve's firmly established growth trend continued in 1974 and strong gains were recorded, resulting in new high levels of achievement. To summarize:

NET INCOME	$ 13,677,000	Up 27%
PER COMMON SHARE	$ 1.08	Up 29%
GROSS REVENUES	$724,721,000	Up 78%
FUNDS FLOW	$ 26,306,000	Up 8%
WORKING CAPITAL YEAR END	$ 28,296,000	Up 3%
SHAREHOLDERS' EQUITY	$ 93,388,000	Up 15%

Major contributing factors in this consolidated corporate growth pattern included continued successful results realized by the Company's major subsidiaries, Western Crude, Mohawk Petroleum and Canadian Reserve (on a restated basis) and also by its U.S. Oil and Gas Division. Each of these components of the Company's business had an excellent operating record for the year.

An important corporate step was taken in January 1974 with the establishment in Denver of the Company's General Operating Office headed by Paul D. Meadows. This was in furtherance of a basic Company objective: to step up, expand and centralize management of the Company's rapidly growing oil and gas exploration and development activities, which have become worldwide. A summary of the Tripco Joint Venture, to which Reserve became a party in 1974, is set forth later on in this report, together with a review of activities in Colombia and the Middle East. As a result of the move to Denver, we have expanded our Exploration group and new emphasis has been placed on exploratory work in the United States, as a long-term objective.

During the year Reserve participated, with varying working interest percentages, in the drilling of 34 wells in the United States; 20 of which were exploratory, resulting in 5 discoveries; and 14 of which were development holes, with 8 successful completions.

In the Reserve-Antweil 50-50 Joint Venture area two successful gas wells were completed in the South Carlsbad Field, New Mexico. In January 1975, Saik #1 commenced gas deliveries at approximately 2.5 million cubic feet per day. Bear #1 is expected to go on stream this month. Six miles northwest of Carlsbad in the Avalon area, two excellent gas wells were completed; Federal #1 is currently producing 4.0 million cubic feet into the sales line and Federal #2 should be connected this month. These wells are producing from the Morrow and Strawn formations at 11,000 feet with the Company's working interests ranging from 17% to 23%. The gas is being sold for 70 cents per MCF.

In the South Lake Charles Field, Louisiana, the Company drilled 2 successful producers and will drill 2 additional wells this year on a 1,900-acre block in which it owns a 12½% working interest. In the Peters Point-Jack Canyon areas in Carbon County, Utah, Reserve, with working interests from 41.5% to 50%, has commenced a Wasatch formation exploration and development operation on an acquired 11,520-acre block on which 2 wells have been restored to production, one new well has been completed and 6 additional wells will be drilled this year.

The exploration and development operations of Canadian Reserve achieved good results. In British Columbia the Company participated in drilling 4 natural gas discoveries, in the Kotcho Lake, Monkman Pass and Tenaka areas, and an oil discovery in the Mike area. At Kotcho another Middle Devonian Reef discovery, b-68-H, had an absolute open flow of 71 million cubic feet of natural gas per day. Sales of gas from this field were initiated in April. At Tenaka, b-84-G, a discovery in the Middle Devonian, flowed at a stabilized rate of 2.5 million cubic feet of gas per day. In Alberta, Canadian Reserve was a participant in 14 exploratory wells, resulting in 3 completions at Ethel, Medicine River and

Lobstick. The Ethel well, where the Company has a 50% interest in 9 sections of land, tested 4.8 million cubic feet per day from 3200 feet. In the heavy crude area of Alberta-Saskatchewan the Company was a participant in 12 exploratory wells, resulting in 3 oil wells and 1 gas well. Two of these oil wells were in the Senlac area of Saskatchewan where an extensive drilling program could be undertaken if satisfactory incentives are restored. In development drilling in Alberta and the heavy crude area 18 oil wells and 3 gas wells, in which Canadian Reserve has partial interests, were completed as producers.

At the Colville Lake area in the Northwest Territories a significant natural gas discovery in the Lower Paleozoic was made on a 664,000-acre block in which Canadian Reserve will retain a 25% interest following extensive geophysical work and projected additional drilling operations to be conducted in 1975 without cost to the Company.

Western Crude Oil, Inc. had the best year in its history in 1974, with revenues at an all-time high. Two major Western Crude projects approached completion as the year ended. Shipments will begin about mid-year 1975 through the Texoma 470-mile, 30-inch common carrier crude oil transportation system running northward from Beaumont, Texas to Cushing, Oklahoma. Western Crude is the second largest participant in this system with a 20% interest. The pipeline system will commence operations with an initial capacity of 300,000 barrels per day. A major utilization of the system will be to provide foreign source crude oil to inland-U.S. refiners.

With the objective of adding another profitable facility in conjunction with its Texoma interest, Western Crude is nearing completion of a $9.5 million terminaling and storage complex near Cushing which it owns 100%. With an initial capacity of approximately 1.5 million barrels, this facility will be made available to all crude oil shippers with interests in the Texoma line or in other major U.S. pipelines which have terminals at the Cushing junction.

The international products trading and transportation business of Wesco International, Inc. and its subsidiary, Easco, S.A., were expanded during the year when new international trading offices were established by Wesco in Beirut and Cairo. Of growing importance during the second half of the year was a new line of business commenced by Western in June—trading in petrochemicals internationally.

For the fifth consecutive year, Mohawk Petroleum set new records in terms of crude runs, product sales, revenues and profits. Gasoline sales were up 5.7% to a new high of 174 million gallons. Sales of diesel oil, Mohawk's second largest volume and value product, increased to 62.7 million gallons compared to 52.2 million gallons in 1973, a gain of 20%.

Mohawk's Bakersfield refinery also established new records. Following the No. 4 Crude Unit expansion completed late in 1973, the official refinery crude capacity rating was increased early in 1974 from 20,500 to 22,100 barrels per day. Runs for the year averaged 18,882 barrels per day, an increase of 17% over 1973.

Mohawk is now operating under numerous highly complex regulatory rules established by the Federal Energy Administration, which has control over virtually every aspect of its business, including the supply, distribution and price of crude oil, the yield of refinery products and the allocation and sale of gasoline and diesel oil. The impact of these controls on Mohawk's profits in 1975 and future years cannot be predicted. There are strong indications, however, that it will continue to be the policy of the national administration to recognize and support the competitive viability of small refineries as a vital force in the energy industry.

Apple Valley development was at a slower rate in 1974 because of inflation, interest rates and environmental regulations. Nevertheless, there were continuing indications of future growth. 1974 was the third highest year in construction starts since development began some 25 years ago. Eleven new business establishments began operating in the Village area and recreational facilities in the immediate region continue to increase.

Energy, nationally and internationally, has become a new world, with new rules and new outlooks developing, some as yet undetermined. Political problems abound, at home and abroad. Tax and government participation factors will have a material effect on the Company's operations and financial results in every area where it has interests. Nevertheless, the development of new energy sources, particularly oil and gas, and the conservation and wise utilization of existing energy supplies, to which Reserve is firmly dedicated, are of such vital concern to all, including governments, that any company in the energy business must perforce persist in its conviction that skill, diligence and alertness to opportunity will surely lead to additional rewards of success. That will be the objective of Reserve's efforts, in a steadfast belief that continued growth can be achieved to the benefit of both the Company and the nation. This will be possible, however, only if companies like yours are not restricted by unrealistic governmental regulations so severe as to weaken or destroy the competitive enterprise economy under which this country and its business enterprises have grown and prospered.

It is a pleasure for me to express the sincere appreciation of management and the Board of Directors for the oustanding performance of the Company's employees in achieving this record year.

John R. McMillan

FOR THE BOARD OF DIRECTORS
John R. McMillan, Chairman

March 21, 1975.

New York Stock Exchange

On August 12, 1974 a long-term goal was achieved—the listing of the common stock of the Company on the New York Stock Exchange. The two pictures depict portions of the activities on the Stock Exchange floor which occurred when the symbol RVO first appeared on the ticker tape. On the same day, trading in the Company's common stock ceased on the American Stock Exchange; but continued on the Pacific Stock Exchange.

The Company's specialist on the New York Stock Exchange is Stokes, Hoyt & Co.

At left, left to right: Directors Dietler, McDuffie, McMillan, Meadows and Green confer with exchange specialist John M. Hirst, Stokes, Hoyt & Co., *fourth from left.*

Below, left to right: John R. McMillan, Paul D. Meadows and Merle S. Wick, Vice President of the New York Stock Exchange, inspecting the tape marking Reserve's first trade on the exchange.

Personnel

In 1974 and early 1975 the management and staff capabilities of the Company were strengthened by the hiring of new personnel, in many cases with proven records of achievement; by promotion to more responsible positions; and redirection of energies to more specific goals. High level appointments included the following:

In Reserve

Harold F. Green, Senior Vice President
J. E. Michaud, Vice President
Thomas L. Deen, Secretary
Owen Miedema, Manager, Foreign Exploration
Rudy C. Berlin, Manager, Geophysics
Marvin W. Neumann, Manager, Administration
Walter R. Jones, General Attorney
William M. Foster, Attorney
Leonard A. Fortner, Risk Management Administrator

In Canadian Reserve

R. Bruce Bailey, Executive Vice President and General Manager
David W. Talbot, Vice President and Treasurer
Don A. Repka, Secretary
J. R. Dundas, Manager, Production

In Mohawk

L. W. Friedman, Director and Senior Vice President
Jack J. Reed, Director
A. M. Ozanich, Vice President

In Western Crude

Norman L. Rooney, Senior Vice President
Sid W. Binion, Senior Vice President
David W. Fagerness, Senior Vice President

George C. Benson, Vice President
Harry E. Davison, Vice President
J. E. Johnson, Vice President
John A. Mills, Vice President
W. Darrell Zang, Vice President

Rex L. Utsler, Manager/Crude Oil Trades and Exchanges

Clark F. Baldwin, President, Wesco International, Inc.
L. J. Hull, President, Spruce Oil Corporation

Left foreground—McMillan, *then clockwise*—Meadows, Bass, Pyle, Cramer, Ball, Green, Aberley, Bixby, Westlund, Holloway, McDuffie and Dietler.

Environmental Activities and Expenditures

Even before regulations were enacted, Reserve had become attentive to the desirability and necessity of conducting its operations and making installations with a view to maximum feasible protection of the environment. Although item by item cost figures have not been kept in this specific category because installations of this kind often serve other purposes also, it is clear that expenditures for these purposes have been very substantial. As an example of this type of activity in respect to oil and gas operations, all unused sumps and uneconomic wells have been abandoned and in all cases the ground has been restored to its original condition. Screen coverings have been installed over oil pits for the protection of wildlife, and whenever any operations have been considered to pose any threat to the environment remedial steps have been taken. This has been true in Canada as well as the United States with such activities as seismic line clean up, tail gas clean up and steel pit installations in replacement of earthen pits. The Company's 1975 estimated share of environmental protection installations in a single Canadian sulfur plant is $180,000.

Equally important, emission control facilities at the Company's refinery installations have been extensive and costly. One installation in 1975 is estimated to involve at least $200,000. Additional work will include floating roof tanks for vapor control and tank truck and pipeline improvements to minimize pollution. In marketing operations in 1974 the costs for installation of vapor recovery systems in service stations and tank trucks, and tanks for the marketing of no-lead gas, exceeded $536,000.

Reserve's policy will continue to be one of maximum compliance not only with regulations but also with the Company's own view of environmental protection.

Description of Business and Lines of Business

The general nature and scope of the business engaged in by Reserve and its subsidiaries involves activities within four principal fields: Oil and Gas Exploration/Production; Refining and Marketing; Oil and Gas Gathering, Transportation, Processing and Marketing; and Real Estate, Warehousing and Miscellaneous. In 1974, these activities consisted of the following:

Oil and Gas Exploration/Production

Domestic exploration and production operations continued in the California, Rocky Mountain and Mid-continent regions with growing emphasis in the Rocky Mountain area. International activities in Canada and Colombia were expanded to include exploratory ventures in the Middle East, the German North Sea, the Baltic Sea and Egypt.

Refining and Marketing

Reserve, through its subsidiary Mohawk Petroleum Corporation, Inc., owned and operated a refinery in Bakersfield, California, and, through its subsidiary Western Crude Oil, Inc., held a 40% interest in a Colorado refinery. Refined products from the respective facilities, together with products acquired by exchange and purchase, were marketed in the California, Arizona, Rocky Mountain and Mid-continent areas.

Oil and Gas Gathering, Transportation, Processing and Marketing

Reserve, through its subsidiary Western Crude Oil, Inc., contracted domestically to purchase, gather, transport, process and market petroleum products for numerous accounts. Western also owned and/or operated, or held interests in, pipeline systems traversing the continental United States. International trading and transportation of petroleum products were conducted by Western's European subsidiaries.

Real Estate, Warehousing and Miscellaneous

Real estate located in the desert community of Apple Valley, California, was sold and developed by Reserve's Apple Valley Ranchos Division. Warehousing operations were conducted in Long Beach, California.

Information as to Lines of Business

The following table sets forth for the last five years the approximate percentages of (i) gross revenues and (ii) pretax income (loss), exclusive of extraordinary items, of Reserve allocable to its primary areas of activity (including gross revenues from oil and gas properties subject to production payments) with corporate overhead and interest expense allocated on the basis of gross revenues for the years indicated:

Percentage of Gross Revenue and Pre-tax Income	1974	1973	1972	1971	1970[2]
Percentage of Gross Revenue:					
Oil and gas production	2.8	3.6	5.0	6.8	6.3
Refining and marketing	19.4	17.1	18.9	22.7	17.6
Oil and gas gathering, transportation, processing and marketing	76.8	77.8	73.9	67.7	72.1
Real estate, warehousing and miscellaneous[1]	1.0	1.5	2.2	2.8	4.0
Percentage of Pre-tax Income:					
Oil and gas production	33.2	15.7	37.5	43.5	40.1
Refining and marketing	25.7	23.8	21.6	24.6	44.7
Oil and gas gathering, transportation, processing and marketing	29.7	49.1	16.6	14.6	18.5
Real estate, warehousing and miscellaneous[1]	11.4	11.4	24.3	17.3	(3.3)

[1] 1971 and prior years restated to account for retail residential land sales on the installment method.
[2] Includes loss from operation of a fertilizer plant discontinued in 1970 and sold in 1971.

Exploration, Development, Operations

Worldwide Outlook

In 1974 the Company's pace in exploration activity was substantially accelerated. Renewed emphasis was placed on the United States, and for the first time the Company's search for new reserves of oil and gas became truly worldwide. At year end exploratory work of various kinds was being conducted or considered by the Company's own personnel or by others on its behalf ranging from the Arctic Islands southward to Colombia in South America, and from Cambodia westward to parts of Africa and into the far western Pacific Ocean and the Philippine Islands; in Alaska and the North Sea and the Baltic and other areas. The Company is now prepared to turn its serious attention to any part of the world where the search for energy sources looks to have favorable chances of success.

Paul D. Meadows, President and Chief Operating Officer.

United States

The Company participated in varying percentages in the drilling of 20 exploratory and 14 development wells in 10 states. This drilling activity resulted in 5 discoveries and 8 successful development wells.

The Reserve-Antweil 50-50 Joint Venture participated in the drilling of three 11,700 foot wells in the South Carlsbad Field, New Mexico (see Map, page 11). Two were completed successfully, the #1 Saik and the #1 Bear. Combined productivity from the two wells has been demonstrated at more than 6 million cubic feet of gas per day. The Joint Venture's working interest in these wells is 41% and 46% respectively. The Joint Venture will participate in the drilling of at least two additional wells in the South Carlsbad area later this year on its 852 net acre holding.

In the Avalon area, approximately six miles northwest of the City of Carlsbad, the Venture participated in the drilling of an 11,000 foot well, Western Reserves Federal No. 1, which found approximately 50 feet of productive Morrow Sand. This well, in which the Venture owns a 47% interest, has been hooked up for a delivery of 4.0 million cubic feet of gas per day. A second well, Western Reserves Federal No. 2 (Venture working interest 34%), was completed early in 1975 and indicated commercial gas producing rates from both the Strawn and Morrow reservoirs. Estimated combined production from the two wells should be in excess of 7.0 million cubic feet of gas per day. The Venture will drill at least one more Avalon well in 1975.

In the South Lake Charles Field, Calcasieu Parish, Louisiana, the Company drilled two wells. The Frieda Blair #1, an offset to the 1973 Lawton-Plauche #1 discovery, encountered a new productive fault block and was completed for 95 barrels of oil and 650,000 cubic feet of gas per day through a ⅛ inch choke with 2850 psi flowing tubing pressure. The #1 Albrecht Heirs, ¾ of a mile west


ARCTIC ISLANDS
Exploration Area
Production Area
Mining Properties
Land Development
Plants and Refineries
Offices
COLVILLE LAKE
KOTCHO
JEANS
CROSSFIELD
Lone Pine
Calgary
Denver
San Francisco
Los Angeles
Tulsa
Dallas
Houston
New York
COLOMBIA
NORTH SEA
BALTIC SEA
London
Rotterdam
Geneva
MALTA
Beirut
Cairo
EGYPT
GULF OF OMAN

Company's Net Share Oil and Gas Sales—1974

	Crude Oil and Natural Gas Liquids - Bbls	Dry and Casinghead Gas - Mcf
Texas	706,618	4,250,582
California	265,164	943,525
New Mexico	193,955	361,149
Wyoming	117,852	307,655
Louisiana	71,568	90,348
Illinois	21,003	—
Saskatchewan	1,407,485	74,751
Alberta	483,337	5,110,875
British Columbia	110,592	885,372
Manitoba	68,265	—
All Others	35,441	180,991
TOTALS	3,481,280	12,205,248
Average per day	9,538	33,439

Wells Drilled

	Gross Wells 1974	Gross Wells 1973	Net Wells 1974	Net Wells 1973
Development:				
Producers	26	67	6.91	12.42
Dry Holes	8	6	2.67	1.05
	34	73	9.58	13.47
Exploration:				
Producers	21	33	7.19	11.49
Dry Holes	51	57	18.45	19.71
	72	90	25.64	31.20
TOTAL WELLS:	106	163	35.22	44.67

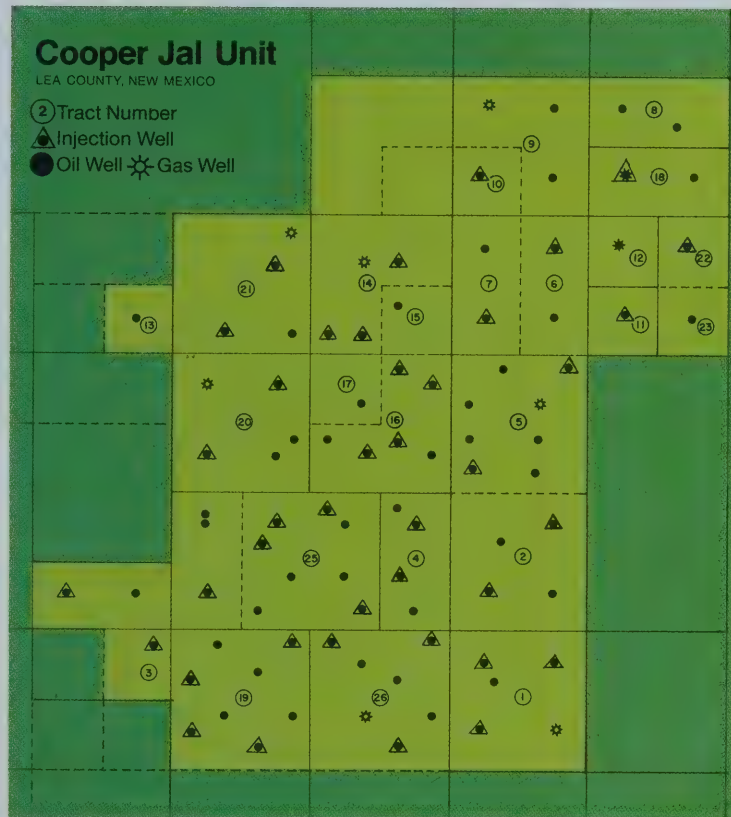
Success Ratios: (Gross)	1974	1973
Development	76.5%	91.8%
Exploration	29.2%	36.7%

of the original discovery area, resulted in another new fault block discovery which was completed for 125 barrels of 40° gravity oil and 580,000 cubic feet of gas per day, through a ⅛ inch choke with 2210 psi flowing tubing pressure. There are additional productive zones behind casing in both of these wells. Two additional development wells are planned for 1975. The Company owns a 12½% working interest in the completed wells and the surrounding 1900-acre block.

Water injection projects operated by the Company continued to respond very favorably in 1974. The Cooper Jal Unit (see Map, page 11) has 95 wells which averaged 1780 gross barrels of oil per day during 1974 as compared to 539 gross barrels per day for 1973. The South Langlie Jal Unit, consisting of 27 wells, averaged 517 gross barrels of oil per day during 1974 as compared to 151 gross barrels per day for 1973. The Company's interest in these two successful units is 22.87% and 40.08% respectively. All oil produced from these units is classified as "new and released oil" and the price at year end was $10.90 per barrel. The geologic formations showing favorable response to the water injection programs in these units include Yates, Seven Rivers and Queens.

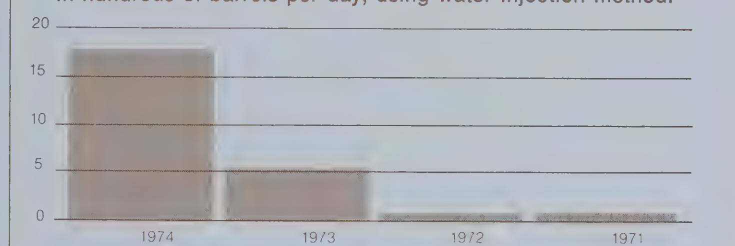
In addition, the Company owns a 5.77% interest in the Langlie Jal Unit, consisting of 36 wells, and a 25.51% interest in the Teas Unit, consisting of 13 wells. These units are operated by others. Both projects are showing initial favorable response from the Yates, Queens and Seven Rivers formations and are expected to contribute significantly to the Company's income for 1975.

The Company has commenced an active Wasatch Formation exploration and development program in the Peters Point-Jack Canyon areas in Carbon County, Utah, on holdings of 2400 acquired acres plus 9460 acres to be earned by the drilling of additional wells. Two of four previously non-productive wells were successfully reworked for a combined daily production of 110 barrels of oil and 1320 MCF of gas. In addition, the Company drilled two wells during the year. One well, Peters Point #9 (work-



Oil Production Cooper Jal Unit

In hundreds of barrels per day, using water injection method.



ing interest 41.6%), was completed for a flow rate of 1914 MCF per day. Gas production is currently shut in, awaiting pipeline outlet. Reworking of two additional wells and the drilling of several more are planned for 1975. The depths of the wells in this area average about 2,800 feet.

Prices for crude oil and other liquid hydrocarbons continued to increase during 1974. Reserve's average domestic sales price per barrel of oil in December 1974 was $7.02 as compared to $6.15 for December 1973, and the Company's average domestic sales price for gas was 31.9¢ per MCF during 1974 as compared to 26.5¢ during 1973. Commencing July 1, 1975 the price to be received by the Company for Northern California gas will be increased from 45¢ to 75¢ per MCF. This increase will apply to 8% of the Company's daily gas production.

Canadian Reserve

Economic Summary

In 1974 financial burdens were imposed on oil and gas operations in Canada which, if not ameliorated, threaten the economic viability of the entire industry, including the majors and the smaller companies. Crude oil and natural gas prices rose to some extent in Canada, reflecting the world price trend, and this resulted in additional revenues to both the Federal and Provincial governments. Notwithstanding this, these governmental bodies in a straight-out competition imposed new financial levies on the oil industry to obtain higher royalty and tax revenues to the extent that future industry operations will in many instances be clearly uneconomic.

As a result of this, most companies, including Canadian Reserve, have for the time being substantially reduced their current operations and have in large measure suspended future plans for exploration and development activity. Your Company has been compelled to postpone indefinitely its potentially most profitable exploration and development programs throughout Western Canada, and at this point the Company is virtually maintaining a holding position.

Fortunately, there were indications early in 1975 that economic realism may prevail again within a reasonably short time in Canada. The Provincial governments in Western Canada have expressed an intention to reassess their situation and modify their stand. There are encouraging signs that an economic climate will be established which will restore the incentive to the oil industry to reinstate intensive exploration and development activity as a vital force in the Canadian economy.

Land

On December 31, 1974 Canadian Reserve held working interests in 17.9 million acres (9.6 million net) and overriding royalty interests in 3.5 million acres throughout Canada in the Western Provinces, Ontario, the Arctic Islands, the East Coast offshore, and the Yukon and Northwest Territories. Productive land holdings of the Company in the Western Provinces increased by 9,570 gross acres to 323,000 acres (89,000 net). Permit applications on the 14.7 million acres (4.9 million net) located off the East Coast of Canada are subject to federal approval upon issuance of new regulations now under consideration.

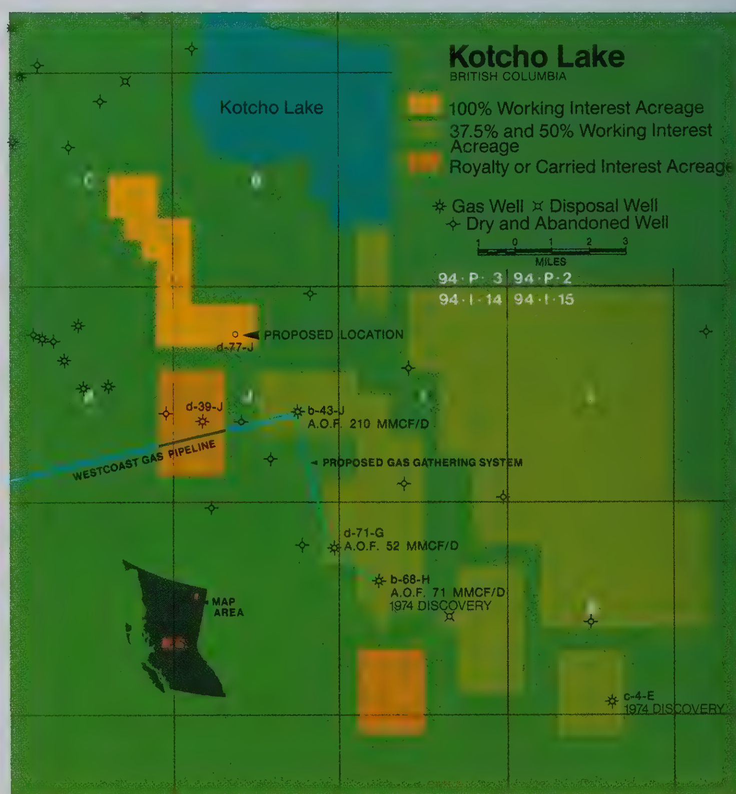
Exploration and Development

During 1974 Canadian Reserve's major exploratory and development efforts were concentrated in the search for natural gas in northeast British Columbia, for oil reserves in the Heavy Crude region of Alberta-Saskatchewan, and for natural gas and oil in the lower risk areas of Alberta.

A summary of the more significant exploration and development activities of 1974 follows:

BRITISH COLUMBIA

During 1974 Canadian Reserve participated in drilling 5 discovery wells (4 gas, 1 oil) plus 2 potential gas wells in northeast British Columbia. The gas discoveries were in the Kotcho Lake, Monkman Pass, and Tenaka areas, the oil discovery was in the Mike area, and the potential gas wells were in the Jeans area.

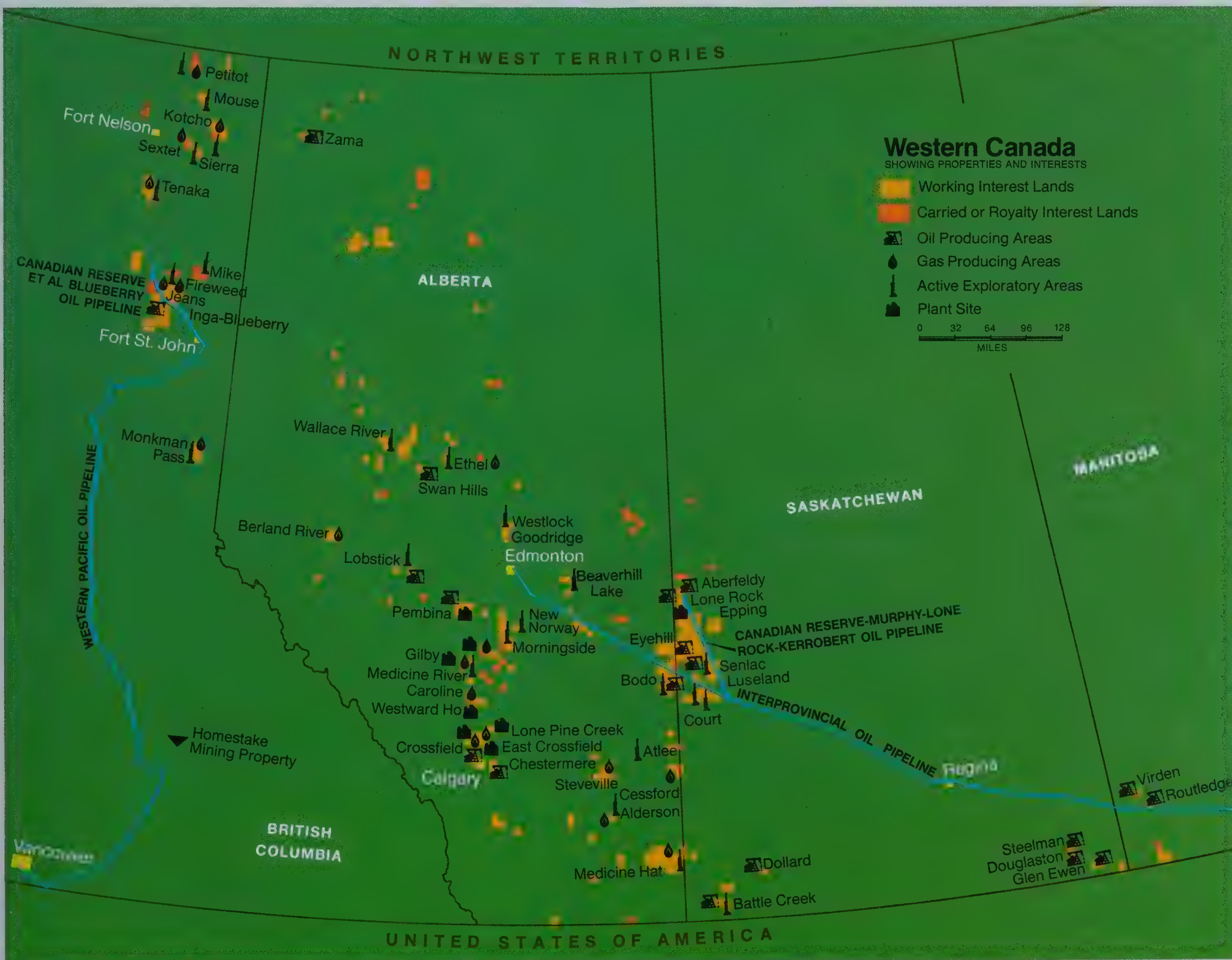


Kotcho Area: Two gas discoveries were made in this area in 1974. The first, well b-68-H, was completed in the Middle Devonian Reef member with an absolute open flow of 71 million cubic feet of gas per day and also was drill stem tested at 2.09 million cubic feet of gas per day from the Cretaceous Bluesky formation. The second discovery, c-4-E, was drill stem tested in excess of 1 million cubic feet of gas per day from a Middle Devonian Reef member. This well is awaiting completion and production testing.

Canadian Reserve holds land interests which vary from 37.5% to 100% in 56,466 acres (29,383 net) in this area.

Tenaka Area: The Company, with partners, drilled a successful Middle Devonian gas well in 1974 at b-84-G, some three miles north of the original a-36-G discovery. At year end, b-84-G was being completed and production testing has indicated a stabilized flow of 2.5 million cubic feet per day.

Canadian Reserve owns interests in 80,794 acres (19,372 net) in the greater Tenaka area.



ALBERTA

During 1974 Canadian Reserve participated in 14 (6.46 net) exploratory wells resulting in 2 gas wells at Ethel and Medicine River and one oil well at Lobstick. Canadian Reserve also participated in 12 (2.14 net) development wells resulting in 10 oil wells and 2 gas wells in the province.

Ethel Area: The Company drilled a 4,000-foot wildcat east of Swan Hills resulting in a Cretaceous sand gas well which was drill stem tested at 4.8 million cubic feet per day. The well earned a 50% working interest in a 9-section block of land with further options to earn additional lands. Further exploration is planned this year.

Lobstick Area: Canadian Reserve, as operator and 50% partner in the original 7,680-acre drilling reservation, participated in 3 Cardium formation tests on this prospect. Two wells were abandoned and the third was completed in an interval from 5,200 feet to 5,208 feet as an oil well with an initial productive rate of 100 barrels of 36° gravity oil per day. Following lease selection, Canadian Reserve now owns 50% of 1,920 lease acres (960 acres net).

HEAVY CRUDE REGION

Alberta-Saskatchewan Area: During the past year Canadian Reserve participated in 10 (2.03 net) development wells resulting in 8 oil wells, one gas well, and one dry hole in the Heavy Crude areas of Alberta-Saskatchewan. Canadian Reserve also participated in 12 (5 net) exploratory wells resulting in 3 oil wells, one gas well, and 8 dry holes in this area.

Senlac Area: Your Company participated as to a 50% interest in the drilling of 2 exploratory wells on this prospect, which resulted in 2 oil wells. The Company also acquired a 50% interest in approximately 1,700 offset lease acres.

In addition to the exploration drilling, the Company purchased partially developed productive properties. Immediate plans call for an extensive production testing program on these properties using conventional and enhanced recovery techniques, which if successful will result in a number of development wells.

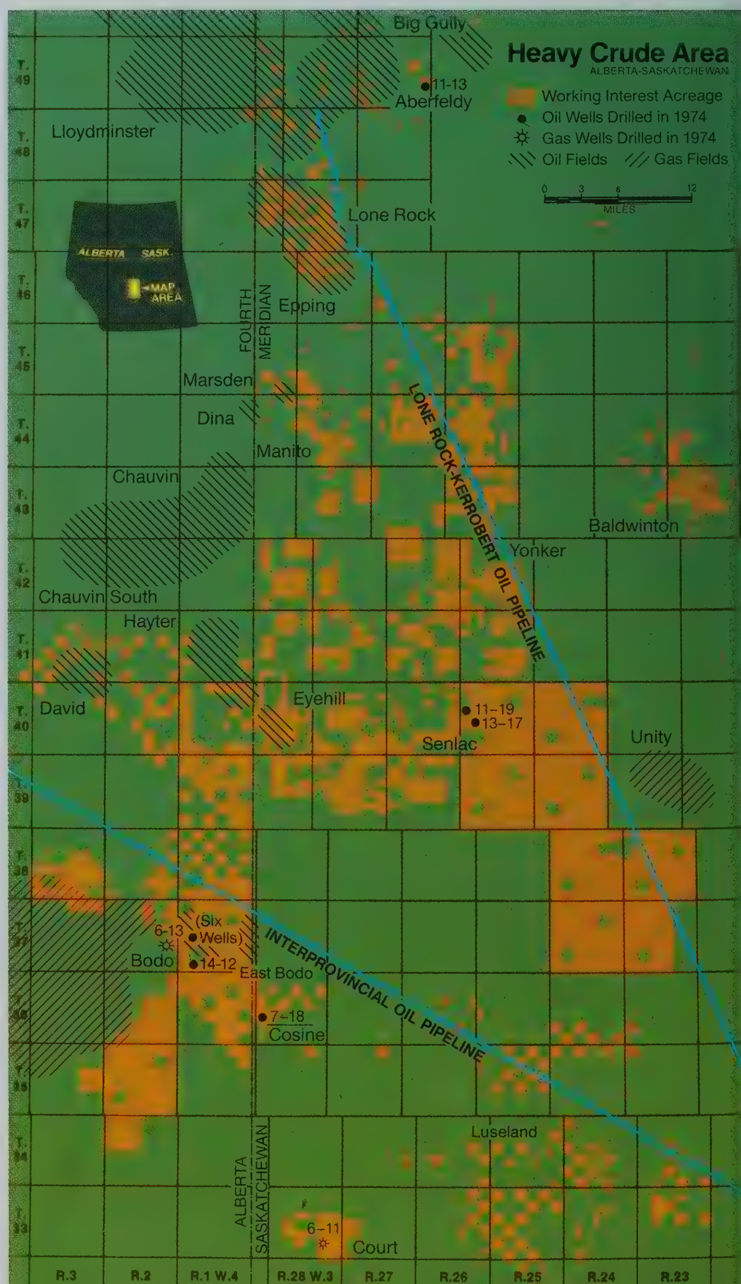
Bodo Area: Canadian Reserve took part in the drilling of 6 (one net) development wells in this Heavy Crude area in Alberta. The wells were all completed as oil producers and are part of a continuing development project in this field.
The Company is a party to an experimental fireflood pilot in the main Bodo pool. It is anticipated that a minimum of two years will be required to meet the objectives of this experimental flood. A successful enhanced recovery scheme could add substantially to the Company's reserves in the Bodo field and other similar heavy oil areas, and lead to extensive development programs.

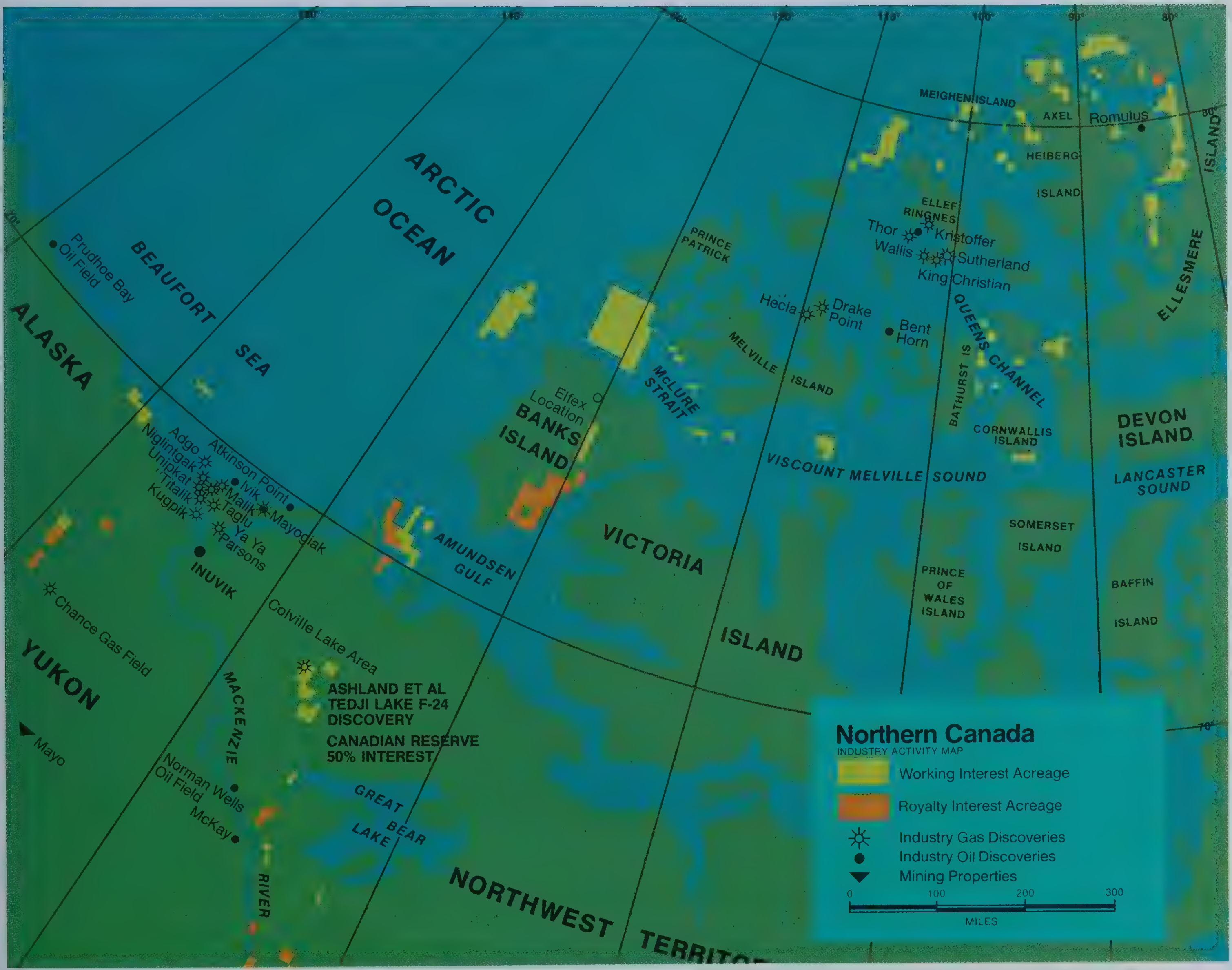
YUKON AND NORTHWEST TERRITORIES

Drilling activities by the industry were reduced in the Northwest Territories in 1974, with approximately 50 exploratory wells drilled as compared to 80 in 1973. Exploration in the Mackenzie Delta, however, remained high. 24 wells were drilled, resulting in 4 gas discoveries, bringing the total to date in the Delta to 17 successful completions (two oil, one dual oil and gas, 14 gas).

Colville Lake Area: The Company participated in a significant gas discovery in the Colville Lake area where it is a major interest owner in Permit lands. The well, Ashland et al Tedji Lake F-24, was drill stem tested up to 4.4 million cubic feet of gas per day from a Basal Paleozoic zone at an approximate depth of 3,800 feet, and thereby proved the existence of hydrocarbons in a large structural closure. An extensive geophysical program to further evaluate the prospect is scheduled for 1975.

In the Northwest Territories and Yukon the Company holds working interests in 1,850,529 acres (938,435 net) and overriding royalty interests in 1,331,999 acres.





ARCTIC ISLANDS

Three successful wildcats and one successful stepout were recorded by the industry in the Arctic Islands during 1974.

Canadian Reserve did not participate in exploratory drilling in the Arctic Islands during 1974, but followed with considerable interest the progress of the Dome Arctic Ventures Crocker I-53 well on Meighen Island. This well was abandoned above intended total depth due to inoperable hole conditions and did not attain or test the principal objective of the well. Canadian Reserve has a 40% interest in 1,147,684 acres of nearby land with similar potential.

Another interesting location is the Elfex et al Kusrhaak D-16 offsetting Canadian Reserve working interest lands on Banks Island. At year end this well was preparing to commence drilling and is intended as a 12,000-foot Paleozoic test.

The Company holds oil and gas rights on 8,970,757 acres (6,207,880 net) and has overriding royalty interests in 1,412,455 acres in the Arctic Islands.

EASTERN CANADA

Exploration was highlighted by 2 discoveries by the Eastern Group in offshore Labrador waters. The Eastcan et al Bjarni H-81 and Eastcan et al Gudrid H-55 wells both tested considerable quantities of water-free natural gas from rumored large structures with thick reservoir sections. Canadian Reserve's 14.7 million acre (4.0 million net) block of Permit applications is located within the same basin as these discoveries but in deeper water.

Canadian Reserve owns 5,044,771 acres (1,827,094 net) of petroleum and natural gas rights off the East Coast of Canada (in addition to its permit applications).

Heavy Minerals Exploration

A limited heavy minerals exploration program was conducted during 1974, with a small joint venture program in the Mayo Area of the Yukon Territory. In addition, another joint venture program was started in the Ironbridge area of Ontario, approximately 60 miles northeast of Sault Ste. Marie, Ontario.

In the Kamloops area of British Columbia, at the Homestake Mine, a 1,910-foot adit was driven into the hillside and a 446-foot raise to the upper level from this adit was completed. The Company's investment plan for the installation of production facilities has been deferred. This action was taken because of the imposition of increased royalty and tax rates during the year by the Government of British Columbia.

Operations

Drilling: During 1974 Canadian Reserve participated in the drilling of 67 wells in Western Canada, a significant reduction of 46% from the 122 wells drilled in 1973. The reduction in drilling was entirely the result of increased Provincial royalty assessments and the taxation policies of the Federal Government.

A total of 48 exploratory wells were drilled, resulting in 6 oil wells, 9 gas wells, and 33 dry holes for a success ratio of 31.3%. Canadian Reserve's interest in the successful exploratory completions resulted in 2.5 net oil wells and 3.4 net gas wells.

Canadian Reserve participated in the drilling of 19 development wells during the year, equivalent to 4.7 net wells. Of these, 13 were completed as oil wells, 5 as gas wells and one was abandoned for a success ratio of 94.7%.

Production: For the first time in over seven years the Company experienced a reduction in net crude oil and natural gas liquids sales during 1974. This reduction from a daily average during 1974 of 6,531 barrels to 5,670 barrels is a direct reflection of the significant increase of royalties claimed by the Alberta and British Columbia governments during the year. Although the base royalty charged by the Saskatchewan government was not altered, the introduction of the royalty surcharge together with the proposed Federal Government sur-tax measures introduced during the year compelled the Company to reduce materially its projected exploratory and development drilling activities and thus contributed to a reversal of the growth pattern established in recent years.

Net natural gas sales during 1974 averaged 16.6 million cubic feet per day, a slight increase over the 1973 average of 16.3 million cubic feet per day. This nominal increase is attributable to new production from the East Kotcho area of British Columbia together with higher deliveries from the Lone Pine Creek Field of Alberta. The increases in these two areas were sufficient to slightly more than offset the large increase in the Alberta provincial royalty demands.

Net average sulfur sales during 1974 amounted to 115 long tons per day for an increase of 3% from the 112 long tons per day in 1973. The Company sold 30,460 long tons during 1974 for an average net back price of $17.24 per long ton, which was a significant increase from $9.00 per long ton received early in the year.

Natural Gas Processing: Canadian Reserve owns interests ranging from 0.67% to 33.3% in seven gas processing plants in Alberta. The Company's most significant plant interests are in the Crossfield, East Crossfield, Sylvan Lake and Lone Pine Creek fields of Alberta.

Its share of plant products from these facilities during 1974 amounted to 6,070 million cubic feet of sales gas, 123,471 barrels of condensate, and 41,966 long tons of sulfur.

Transportation: Canadian Reserve owns a 47.5% interest in the 101-mile Lone Rock-Kerrobert pipeline system which transports a crude oil-condensate blend from the Lloydminster area of Saskatchewan to connect with the Interprovincial Pipeline at Kerrobert, for delivery to the Ontario and Chicago marketing areas.

During 1974 the Lone Rock-Kerrobert pipeline delivered 3,018,000 barrels of blend to the Interprovincial line. This averaged 8,268 barrels per day, a decrease of 3% from the 1973 daily average of 8,566 barrels per day. This reduction was caused mainly by a decrease in exploratory and development drilling in the Heavy Crude area due to uncertainties in governmental policies, together with a reduction in sales to the U.S. markets during the month of November brought about by an excessive export tax.

In Northeastern British Columbia, Canadian Reserve owns a 21.67% interest in a 72-mile pipeline which transports crude oil from the Aitken Creek, Blueberry and Inga fields to Taylor Flats for movement via other pipelines to West Coast refineries. This system, capable of handling 15,000 barrels per day, had income of approximately $46,000 to Canadian Reserve's account in 1974.

Western Crude

Total 1974 revenues from all sources reached the highest level in the Company's history.

One of the Company's major projects moved ahead and will culminate in 1975 with the commencement of operations by Texoma Pipe Line Company. Tardy pipe deliveries and continuing adverse weather conditions have been delaying factors in the projected completion of the Texoma system. Shipments through this 470-mile, 30-inch common carrier crude oil transportation system will begin by mid-year. The delays, and other factors, are now estimated to have increased the total cost of the pipeline project by about 29%. The pipeline system, with an initial capacity of 300,000 barrels per day, will run northward from Beaumont, Texas to Cushing, Oklahoma and will provide a vital link in the central United States network of crude oil pipeline transportation

facilities. Western Crude owns 20% of Texoma and is the second largest participant. The operator of the pipeline system is Sun Pipe Line Company, a subsidiary of Sun Oil Company. A major utilization of the system will be in providing foreign-source crude oil to inland refiners.

As an adjunct to its participation in the Texoma system, Western Crude is close to completion of another sizable facility which it will own outright. This will be a $9.5 million terminaling and storage complex near Cushing which will offer services both to Texoma shippers and to customers who will otherwise have need of these facilities because of their location at a major U.S. pipeline junction. The aggregate initial capacity of this facility will be approximately 1.5 million barrels, and its services will be available to all crude oil shippers irrespective of the origin of the shipment.

The marketing activities of the Company continued to produce favorable results and were substantially better in 1974 compared to 1973. Good gains were recorded, particularly by Pontotoc Oil

Front Row, Left to Right: Paul D. Meadows, President, Reserve Oil and Gas Company, Denver; Hans G. Hachmann, Attorney, Wesco International, Inc., New York; John J. Linehan, Executive Vice President, Wesco International, Inc., New York; Clark F. Baldwin, President, Wesco International, Inc., New York; Dr. Rafic Chahine, Chairman, Easco International S.A.r.L., Beirut; Cortlandt S. Dietler, President, Western Crude Oil, Inc., Denver; William P. Lear, Jr., Director, Easco S.A., Geneva.

Back Row, Left to Right: Kees Teeuw, Manager/Product Trading, Easco International B.V., Rotterdam; Malcolm McDuffie, President, Mohawk Petroleum Corporation, Inc., Los Angeles; Matthew C. H. Hugenholtz, Managing Director, Easco International B.V., Rotterdam; David W. Fagerness, Senior Vice President/Finance, Western Crude Oil, Inc., Denver; Tony Spoerri, Manager/Finance & Accounting, Easco S.A., Geneva; Errol Boyle, Managing Director, Eastern Marine Limited, London; William E. Glass, Jr., Managing Director, Easco S.A., Geneva; Elias N. Makhuli, Managing Director, Easco International S.A.r.L., Beirut; Dr. Hans J. Rohrer, Director, Easco S.A., Zurich; Owen Miedema, Manager/Foreign Exploration, Reserve Oil and Gas Company, Denver.

Not Pictured: Aly Elwy, Representative, Easco S.A., Cairo.

Company, a subsidiary of the Company, whose principal business is the wholesale marketing of liquefied natural gas products. Late in the year, Pontotoc established new offices in Houston to coordinate the growing marketing activities of its Tulsa headquarters. Petroleum product prices declined somewhat toward the end of the year, but were acceptable for the year as a whole.

The Grand Junction Refinery, in which Western Crude has a 40% joint venture interest, encountered a number of delays in a program to attain full operating capacity, but facility readiness was substantially improved as the year progressed. With the installation of additional new equipment, primarily tankage, which will be completed soon, a prior inventory handling deficiency will be alleviated.

Recent developments in respect to the establishment of expanded oil shale recovery facilities in Western Colorado by the Paraho consortium point to new opportunities for the Grand Junction Refinery to participate in both research and product activities in connection with oil shale, which was a part of the projected outlook envisioned when Western Crude acquired its position in the refinery.

Another of the major contributors to the revenues and profits of Western Crude in 1974 was the international products trading and transportation activities of Wesco International, Inc. and its subsidiary, Easco, S.A. In addition to previously established offices in New York, Geneva, London and Rotterdam, new international trading offices were established during 1974 in Beirut and Cairo.

In June of 1974 Western Crude expanded into a new business field by forming, with a German company, a 50-50 joint venture under the name Inchemco. With headquarters in Hamburg, Germany and Houston, Texas, Inchemco G.m.b.H. and Inchemco, Inc. trade both in the United States and on a worldwide basis in all forms of petrochemicals. Operations have shown substantial growth from the inception of this business.

Looking to the future, both short and longer term, three steps taken by the Company in 1974 are noteworthy. First, capital commitments made during the year and continuing into 1975 are the largest ever undertaken and are anticipated to contribute ultimately to increased revenues and profits. Second, with that objective in view, major executive changes were made, both in Western Crude itself and in the Company's subsidiaries. All of the Western Crude companies are now more adequately staffed with personnel capable of improving the positions of these companies in their highly competitive interdependent lines of business. Third, to complement its far-reaching activities the Company is establishing a new natural gas department, with the objective of moving much more significantly into the gathering, transmission and handling of natural gas.

Pipe for the Neches River Crossing is readied for the 80′ deep trench being dug by the dredge. Union 76's Smith's Bluff Refinery lies across the river. *Below:* The laying of 30″ pipeline in Area 2 on the north side of the Angelina River in Nacogdoches County, Texas.

Mohawk

Effective January 15, 1974 Mohawk Petroleum Corporation, Inc. commenced operations under mandatory regulations issued by the Federal Energy Administration pursuant to the Emergency Petroleum Allocation Act of 1973. These regulations control the supply, distribution and price of crude oil processed in the refinery, provide for controlling the yield of products produced by the refinery, and control the allocation and sale of Mohawk's principal products, gasoline and diesel oil, as to both volumes and prices. Notwithstanding this domination of its activities by the federal government, Mohawk, which became a wholly owned subsidiary of Reserve in 1969, has for the fifth consecutive year achieved higher levels of crude runs, product sales volumes, revenues and profits. In gasoline marketing—the company's principal product—sales increased 5.7% to 174,549,646 gallons, an achievement brought about through the joint efforts of the company's Supply and Distribution Department and its three Marketing Divisions located in Northern, Central and Southern California.

During the early part of 1974, demand for motor gasoline substantially exceeded available supplies, resulting in temporary dislocation and shortages both in wholesale distribution and at the retail level. Mohawk cooperated to the fullest extent possible with state and federal allocation orders, reducing inventories to the lowest feasible working level. In mid-year, as the impact of the Arab embargo subsided, coupled with lower consumption resulting from the 55 M.P.H. speed limit, higher prices, and general recognition of the necessity for conservation on the part of motorists, supplies of gasoline became fully sufficient to meet market demand and remained satisfactory during the balance of the year. Profits derived from the company's gasoline marketing activities, while in full compliance with strict price regulations continuously monitored by the Federal Energy Administration, were substantially higher due principally to the general absence of the retail price wars to which the California gasoline industry traditionally has been subject.

At year end, Mohawk products were being marketed through 285 retail outlets, an increase of 15 units since 1973. These comprise 176 Mohawk branded service stations and 109 outlets selling Mohawk products re-branded to other trade names. Marketing was also handled through approximately 88 jobbers, commercial customers and other accounts located in 159 cities and towns in California and Arizona. 23 of the Mohawk branded service stations are company operated with the balance being operated by independent lessees and dealers.

Sales of diesel oil, Mohawk's second largest product in both volume and value, totaled 62,672,014 gallons compared to 52,243,413 gallons in 1973, an increase of 20%. This product is distributed principally to a major railroad on which the Mohawk refinery is located, to the farming industry throughout California's San Joaquin Valley, as a fuel for the trucking industry,

Architect's rendering of station under construction at 28th Avenue and El Camino Real, San Mateo.

and to a neighboring refinery as a hydrocracker feedstock. Under the rigidly inflexible price controls enforced by the Federal Energy Administration, Mohawk has been forced to sell this product at considerably less than its prevailing market price. This inequitable situation results principally from the fact that the federal agency does not distinguish in its price control mechanism between the highly price-protected heating oils so important to the U.S. East Coast and the diesel fuels used for transportation and farm equipment in the west, classifying them together.

Operating Highlights 1974

Refinery Thruput	6,892,006 Bbls.	18,882 Bbls. per Day
Gasoline Sales	174,549,646 Gals.	14,545,804 Gals. per Month
Diesel & Stove Oil Sales	63,425,182 Gals.	5,285,349 Gals. per Month

Station at 19th Avenue and Santiago Street, San Francisco.

San Francisco station located at Army Street and South Van Ness Ave.

As a result of expanding the capacity of its No. 4 crude unit late in 1973, Mohawk's official crude capacity rating was increased in January, 1974 from 20,500 to 22,100 barrels per day. Actual runs for the year averaged 18,882 barrels per day, an increase of 17% over 1973, and the highest in the company's history. Additional supplies of oil to achieve this level of operation were made available through the efforts of Reserve's subsidiary, Western Crude Oil, Inc. and by purchases from other companies under the FEA's Mandatory Crude Oil Allocation Program. At this level of refinery runs, Mohawk gasoline production represented approximately 55% of its total sales. The difference between sales requirements and production was acquired from other refineries in California through purchase or exchange, and it is anticipated that such arrangements will be continued during 1975.

Responding to requirements of the Environmental Protection Agency, Mohawk installed facilities during 1974 in each service station either owned or leased by the company for the storage and dispensing of unleaded gasoline. This requirement stems from the decision of the automobile industry to utilize catalytic converters as a means to achieve 1975 automobile emission standards imposed under terms of the Clean Air Amendments of 1973. Sales of unleaded gasoline during 1974 were 4,498,919 gallons, or about 2.5% of total gasoline sales, confirming the company's judgment—as set forth in last year's Annual Report—that the requirement for supplying this product in each of its service stations was unnecessary and onerous in view of the limited demand then anticipated for unleaded gasoline.

In addition, we reported in 1973 that Mohawk had joined the National Petroleum Refiners Association and other refiners in an action before the United States Court of Appeals for the District of Columbia against the EPA requesting that the Agency's regulation requiring the removal of lead from all gasoline, based on its alleged hazard to public health, be remanded. Your company was gratified by the decision of the Court on December 23, 1974 setting aside the Regulation, which we consistently held was illegal, unreasonable, would have compounded the energy shortage, and would have required an unwarranted capital investment by Mohawk. It was the Court's opinion that EPA had failed to prove that lead from automobile emissions constitutes a health hazard. The EPA has appealed.

All facets of Mohawk's business are subject to complex, constantly changing governmental regulations which it is anticipated will continue to affect its operations throughout the foreseeable future. The FEA's Crude Oil Entitlements Program, for example, could substantially reduce Mohawk's 1975 earnings. Mohawk has obtained partial relief which, through continued effort, it seeks to expand and extend.

Foreign Exploration and Development

Colombia

1974 operations in Colombia were marked by a considerable degree of success, both in drilling and seismic work, tempered by two unsuccessful wells. The Burdine #1 well was completed with three zones indicating productive capacity from Upper Cretaceous Villetta sands. On limited flow tests the "N" sand produced at a rate of 1,185 barrels per day of 26° gravity oil, the "T" sand at a 1,430 barrel rate of 37° gravity oil, and the "U" sand at a 472 barrel rate of 33° gravity oil. In January 1975 the Burdine #3, a southerly stepout from the Burdine structure discovery well, flowed initially at a rate of 1,700 barrels per day of 21° gravity oil from the "N" sand at 10,004 feet.

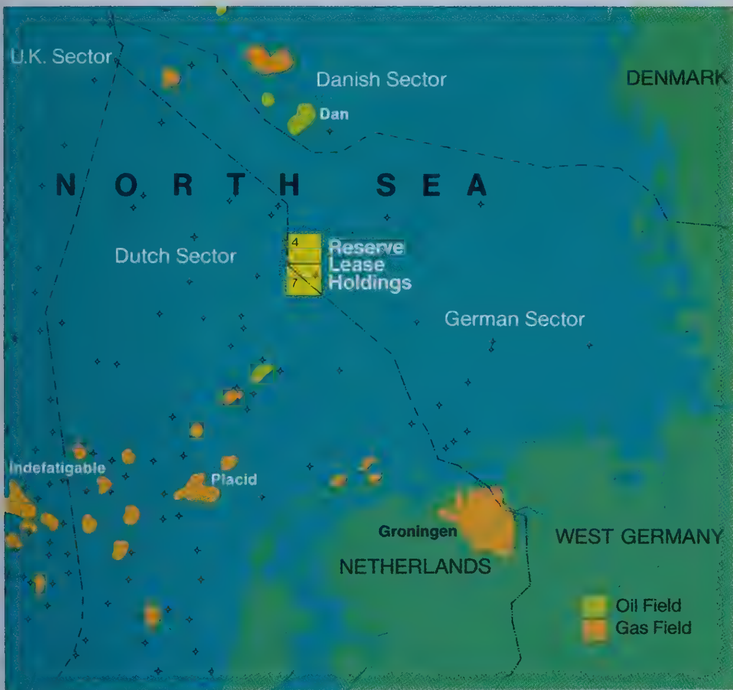
The Setuko #1 well was abandoned after failing to encounter reservoir sands. The Burdine #2 found oil in the "N" sand, but because of low indicated productivity was temporarily abandoned and left in a condition for possible future re-entry.

There are now three completed wells with an indicated aggregate productive rate of 7,147 barrels per day. Marketing has not commenced pending pipeline arrangements and, equally important, the outcome of discussions with Colombian governmental authorities as to oil prices. Satisfactory resolution of the price matter is anticipated.

Approximately 1,200 miles of seismic lines were shot on the Seismic Option area (2,545,000 acres) and the Association Contract Areas, resulting in the delineation of a number of drillable prospects. The Seismic Option area has now been converted to six new Association Contract Areas comprising a total of 1,443,068 acres. Reserve's 12½% interest in the total Colombian concession now represents a net acreage holding of 235,536 acres.

The Consortium will conduct drilling operations in 1975 on the new Association Contract Areas to meet a $1,800,000 expenditure obligation. Further, if a satisfactory oil price schedule is agreed upon, additional drilling will be scheduled, both exploratory and development.

At left: Sheikh Sultan Ben Mohammed Al-Qasimi—Ruler of Sharjah, Judge Y. M. Dweik, Paul D. Meadows, Dr. Rafic Chahine. *On right:* Sheikh Hamad Ben Mohammed Al-Sharqi—Ruler of Fujairah.



Middle East

In July Reserve took a major step in its foreign exploration program with the signing of two oil exploration concession agreements in the Middle East with the governments of the United Arab Emirates of Sharjah and Fujairah.

The two concessions cover extensive contiguous offshore lands in the Gulf of Oman (see map), comprising an aggregate block of approximately 900,000 acres. The nearest oil field, Mubarek, lies about 80 miles west of the western edge of the block.

In December Reserve completed in excess of 1,000 miles of marine seismic and gravity surveys on the two concession areas. The Company is now in the process of interpreting the geophysical data for the purpose of delineating the most promising features in this highly potential geological area for the discovery of substantial oil and gas accumulations.

With the consent of His Highness Sheikh Sultan Ben Mohammed Al-Qasimi, Ruler of Sharjah, and the consent of His Highness Sheikh Hamad Ben Mohammed Al-Sharqi, Ruler of Fujairah, the two concessions have been assigned to Eastern Reserve Oil, S.A., a wholly owned subsidiary, with offices in Geneva and Beirut.

Tripco Venture

On July 1, 1974 Reserve entered into a Joint Venture Agreement with Tripco Petroleum, Inc., a company with principal offices in New York and London established to seek out and obtain petroleum and minerals concessions and prospects throughout the world. Tripco is managed and staffed by highly qualified professionals, with worldwide technical and managerial expertise.

Reserve acquired a 20% interest in the Venture and in the properties then held by it and subsequently obtained, wherever located. The other Venture parties are Tripco (20%), with certain carried rights, City Petroleum Company, New York (40%) and Drillamex, Inc., also New York (20%); the latter two being the exploration-oriented subsidiaries of City Investing Company and American Express Company, respectively. Separate from its 20% working interest, Reserve also acquired a 12½% equity ownership in Tripco.

In addition to a number of other potential concessions and prospects in various parts of the world now under consideration by Tripco, the Venture is currently participating in three major exploration prospects summarized below.

In the North Sea the Venture owns interests in an exploration prospect held under licenses which in the aggregate cover 166,972 acres lying partly in the German Sector and partly in the Dutch Sector (see map). The Venture participated in a 13,000 foot Rotliegendes test in Block G-7. Shows of natural gas in the G/7-1 well were encountered in a Cretaceous sandstone and also in the primary objective, the Permean Rotliegendes sandstone, but the well was abandoned as non-commercial in Decem-

ber. An outside major company also participated in this well, so the final earned position in the German Sector lands for the Venture is 20%. The current working interest position in the Dutch sector lands is 40%. Reserve's net acreage holding in the two Sectors is 10,800 acres. The potential of other structures on this prospect will be further evaluated during 1975.

In the Baltic Sea the Venture holds a concession covering approximately 116,000 acres in the West German Baltic. The Venture and Placid Oil will jointly conduct a seismic program on these lands and Placid will then have the option to drill an initial exploratory well at its sole expense to validate its 50% interest. Reserve's net acreage position will be 11,600 acres. The Venture has an application pending for further exploration licenses on adjoining areas.

In Egypt (see map) the Tripco Venture has acquired a concession covering approximately 1,778,000 acres. An initial photogeological survey on this prospect has shown an attractive structural environment, with indications of sedimentary strata in excess of 10,000 feet. Both regional and detailed seismic surveys commenced in January, and if a structure is delineated a well will be drilled in the second half of 1975. Reserve's net interest comprises approximately 355,600 acres.

Acreage and Producing Wells

	Working Interest Acreage								
	Gross Acreage	Undeveloped Acreage		Developed Acreage		Royalty Acreage		Oil and Gas Wells	
		Gross	Net	Gross	Net	Gross	Net	Gross	Net
United States									
California	15,466	2,778	1,991	12,688	4,450	2,772	75	637	102.12
Colorado	49,549	48,909	15,298	640	240	3,360	11	6	2.00
Illinois	15,472	6,817	5,590	8,655	74	4,814	332	308	2.62
Kansas	27,926	24,394	13,321	3,532	502	14,382	185	6	.99
New Mexico	35,737	14,498	2,282	21,239	3,202	320	5	140	22.49
Oklahoma	11,918	440	190	11,478	362	14,870	165	202	5.03
Montana	23,246	23,246	13,646	—	—	—	—	—	—
Texas	77,299	28,579	12,484	48,720	11,880	107,422	650	486	87.43
Utah	37,505	36,225	32,047	1,280	529	42,648	1,279	6	2.60
Wyoming	248,189	193,568	90,044	54,621	1,513	61,417	1,254	143	9.87
All Others	23,347	8,202	2,505	15,145	528	20,452	1,931	237	11.00
Total	565,654	387,656	189,398	177,998	23,280	272,457	5,887	2,171	246.15
Canada/Alaska									
British Columbia	544,937	354,686	85,594	190,251	35,686	51,524	736	167	18.18
Alberta	793,075	725,396	210,660	67,679	21,722	132,364	3,397	1,205	47.45
Saskatchewan	699,682	646,883	226,339	52,799	19,306	582,254	716	1,752	283.23
Manitoba	8,832	5,894	2,820	2,938	1,186	1,413	25	365	13.36
Northwest Territories	1,346,955	1,346,955	639,595	—	—	1,183,527	28,669	—	—
Ontario	2,751	2,751	1,216	—	—	—	—	—	—
Yukon Territory	503,574	503,574	189,972	—	—	148,472	3,933	—	—
East Coast	5,044,771	5,044,771	1,615,151	—	—	—	—	—	—
Arctic Islands	8,970,757	8,970,757	5,487,766	—	—	1,412,455	37,459	—	—
Alaska	29,104	28,944	18,074	160	48	6,002	406	1	.30
Total	17,944,438	17,630,611	8,477,187	313,827	77,948	3,518,011	75,341	3,490	362.52
Overseas									
Sharjah-Fujairah	900,000	900,000	900,000	—	—	—	—	—	—
West Germany, North Sea	166,972	166,972	10,800	—	—	—	—	—	—
Baltic Sea	116,000	116,000	11,600	—	—	—	—	—	—
Egypt	1,778,000	1,778,000	355,600	—	—	—	—	—	—
Colombia	1,884,288	1,883,328	235,416	960	120	—	—	3	.38
Total	4,845,260	4,844,300	1,513,416	960	120	—	—	3	.38
GRAND TOTAL	23,355,352	22,862,567	10,180,001	492,785	101,348	3,790,468	81,228	5,664	609.05

Apple Valley Ranchos

Apple Valley Ranchos, the real estate division of Reserve, reported revenues of $3.8 million in 1974, compared with $4.2 million in 1973. These primarily represent income from the sale of subdivided property owned in fee by the Company and also comprise commission income from the sale of properties owned by others, revenues from hotel operations and public utility water sales.

Operating revenues, subdivision activity and housing starts all reflected a decline in 1974 for a number of reasons. These included the impact of inflation, interest rates and new environmental regulations. Solutions to these problems will not be immediate but none of them have reached proportions which threaten to any major degree the profitability of the continuing development of Apple Valley. If the economy as a whole can be restored to a more stable condition, and if solutions now under consideration with respect to current environmental problems can be realized, it is anticipated that the growth rate which prevailed in Apple Valley for many years will again be resumed.

In the meantime the Valley continues to grow albeit at a slower pace. 1974 was the third highest year in construction starts from the inception of the development more than 25 years ago. Construction of the Alpha Beta Market shopping center has commenced, and recently eleven new business establishments began operating in the FHM Investment Corporation shopping center located in the "Village" area, including Safeway, Thrifty Drugs and Sprouse-Reitz. The Apple Valley Chamber of Commerce now has 180 memberships, 55 of which were new in 1974. Apple Valley Ranchos Water Co., a public utility company owned and operated by the Company, laid 11,000 feet of new water pipeline in 1974 and now serves 2,500 residential and commercial customers.

The Apple Valley Inn, a popular resort owned and operated by your Company was improved in 1974 and offers a variety of activities to its guests, including horseback riding, swimming, tennis and golf on a beautiful 18-hole championship golf course.

Community development is keeping pace with population growth. An expanded surgical pavilion at St. Mary's Desert Valley Hospital is now nearing completion, a new student center at Victor Valley College is now open and additional facilities to meet school needs are scheduled.

Recreational facilities in the Apple Valley region continue to be expanded and improved and are attracting growing numbers of users. The proximity of these to the Valley enhances local business opportunities in varied ways. Among the major recreational areas are those at Cedar Springs Dam and Silverwood Lake, the Mojave Forks Reservoir Dam and the Mojave Narrows Regional Park.

The easy accessibility to Apple Valley from the metropolitan Los Angeles area, only ninety miles away, enhances the outlook for further growth in Apple Valley.

Consolidated Balance Sheet

December 31, 1974 and 1973

Assets

	1974	1973
	(In Thousands)	
Current assets:		
Cash—including short-term investments in 1974 of $40,073,000	$ 48,799	$ 31,702
Accounts receivable	81,986	70,003
Installment contracts, commissions and notes receivable, net	995	928
Inventories	9,310	9,504
Prepaid expenses	1,115	1,132
Total current assets	142,205	113,269
Long-term receivables and investments:		
Installment contracts, commissions and notes receivable, net	5,219	4,762
Undeveloped land and other investments, at lower of cost or market	4,822	2,418
	10,041	7,180
Properties, at cost:		
Oil and gas properties	95,259	84,753
Refining, manufacturing and distributing facilities	36,727	30,626
Commercial and other properties	7,634	6,880
	139,620	122,259
Less accumulated depletion and depreciation	53,745	47,984
	85,875	74,275
Other assets, at cost less amortization	3,121	1,819
	$241,242	$196,543

Liabilities and Shareholders' Equity

	1974	1973
Current liabilities:		
Notes payable, current portion	$ 2,134	$ 2,150
Accounts payable and accrued liabilities	102,145	78,861
Refined oil products due under exchange agreements	1,117	103
Income taxes payable	8,513	4,664
Total current liabilities	113,909	85,778
Notes and other long-term payables	17,457	16,095
Deferred income taxes	13,315	9,472
Minority interest	3,173	3,844
Shareholders' equity:		
Capital stock:		
Convertible preferred stock, $25 par and involuntary liquidating value; authorized 800,000 shares; 1974—issued 310,027 shares (including 2,558 treasury shares)	7,751	7,753
Common stock, $1 par value; authorized 30,000,000 shares; 1974—issued 12,279,059 shares (including 4,460 treasury shares)	12,279	12,279
Capital in excess of par value	22,837	22,859
Retained earnings	50,546	38,520
Treasury stock, at cost; 1974—2,558 shares Series B preferred shares and 4,460 common shares	(25)	(57)
Total shareholders' equity	93,388	81,354
	$241,242	$196,543

See accompanying Financial Review and Summary of Accounting Policies.

Consolidated Statement of Income and Retained Earnings

Years ended December 31, 1974 and 1973

	1974	1973
	(In Thousands)	
Revenues:		
Petroleum product sales	$712,181	$398,724
Interest and dividend income	3,877	2,029
Real estate and other income	8,663	5,254
	724,721	406,007
Costs and expenses:		
Cost of sales and operating expenses	673,895	362,888
Selling and administrative expenses	14,382	12,314
Depletion, depreciation and abandonments	7,488	9,187
Interest expense	2,177	1,762
Minority interest	505	1,110
Federal, state and foreign income taxes	12,597	9,978
	711,044	397,239
Income before extraordinary credit	13,677	8,768
Extraordinary credit	—	2,000
Net income	13,677	10,768
Retained earnings, beginning of year	38,520	27,680
Income of pooled company, three months ended December 31, 1972	—	495
Dividends	(1,651)	(423)
Retained earnings, end of year	$ 50,546	$ 38,520
Per share of common stock: (in dollars)		
Income before extraordinary credit	$1.08	$ .68
Extraordinary credit	—	.16
Net income	$1.08	$ .84
Dividends	$ .10	$ —

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1974 and 1973

	1974	1973
	(In Thousands)	
Source of funds:		
Operations:		
Income before extraordinary credit	$13,677	$ 8,768
Items not involving working capital:		
Depletion, depreciation and abandonments	7,488	8,909
Provision for deferred income tax and income tax offset by extraordinary credit	3,843	5,533
Other (including minority interest)	1,298	1,186
Total from operations	26,306	24,396
Collections on long-term notes receivable	1,594	429
Proceeds from sales of stock and note conversions by subsidiaries	8	1,462
Proceeds from loans	8,708	19,488
Proceeds from sale of properties	859	2,537
Operations of pooled company, three months ended December 31, 1972	—	801
Other	1,260	74
	38,735	49,187
Disposition of funds:		
Additions to properties	19,455	14,249
Payments and other decreases in long-term liabilities	8,531	20,067
Additions to investments and other assets	3,683	1,463
Purchase of minority interest	2,843	—
Additions to long-term notes receivable	1,743	117
Dividends	1,651	423
Other	24	5
	37,930	36,324
Increase in working capital	$ 805	$ 12,863

See accompanying Financial Review and Summary of Accounting Policies.

Financial Review

Earnings and Revenues. Reserve's results were again at record high levels in 1974. Net income amounted to $13,677,000 in 1974, equal to $1.08 per share on the 12,273,000 average common shares outstanding during the year. This is an increase of 29% per share over restated 1973 net income of $10,768,000, equal to $.84 per common share. Net income in 1973 included an extraordinary credit of $2,000,000 ($.16 per share), representing a federal income tax reduction attributable to loss carryforwards. There was no extraordinary credit in 1974.

Revenues in 1974 rose 78% to $724,721,000 compared with revenues of $406,007,000 reported in 1973.

Net income for 1973 has been restated to reflect the retroactive adoption by Reserve's Canadian subsidiary of deferred income tax accounting related to drilling and exploration costs.

Dividends. Reserve paid its first cash dividend on its common stock in 1974. Common stock dividends totaled $1,228,000 and were paid at the rate of five cents per share in June and in December, 1974. Regular quarterly dividends totaling $423,000 were paid on the four issues of preferred stock at the annual rate of $1.375 per share.

Changes in Financial Position. Funds generated from your Company's operations amounted to $26,306,000 in 1974 and compare with funds so generated in 1973 of $24,396,000. Other funds provided in the year included $8,708,000 of proceeds from loans. Disposition of funds included a record high of $19,455,000 for additions to properties, $8,531,000 for payments and other decreases in long-term liabilities, $2,843,000 for purchase of the 20% minority interest in Wesco International, Inc., and $1,651,000 for dividends on common and preferred stock.

Working Capital amounted to $28.3 million at the end of 1974, and compares with $27.5 million at the end of 1973. The changes in the various elements of working capital are as follows:

	1974	1973
	(In Thousands)	
Increase (decrease) in current assets:		
Cash	$17,097	$ 7,333
Accounts receivable	11,983	46,448
Installment contracts, commissions and notes receivable	67	(1)
Inventories	(194)	4,261
Prepaid expenses	(17)	(63)
	28,936	57,978
Increase (decrease) in current liabilities:		
Notes payable, current portion	(16)	(1,745)
Accounts payable and accrued liabilities	23,284	43,564
Refined oil products due under exchange agreements	1,014	(1,137)
Income taxes payable	3,849	4,433
	28,131	45,115
Increase in working capital	$ 805	$12,863

Installment Contracts, Commissions and Notes Receivable totaled $6,214,000 at the end of 1974 compared with $5,690,000 at the end of 1973, after allowance for loss ($105,000 in 1974; $125,000 in 1973) and deferred profit on residential land sales contracts and commissions receivable ($3,475,000 in 1974; $4,691,000 in 1973). Annual maturities approximate $1,471,000 in 1975 and decline approximately $100,000 per year to $1,050,000 in 1979.

Inventories at the end of 1974 and 1973 are as follows:

	1974	1973
	(In Thousands)	
Petroleum products and sulfur	$6,137	$7,308
Subdivided land, principally under development	1,619	1,551
Materials and supplies	1,554	645
	$9,310	$9,504

Notes and Other Long-Term Payables. At December 31, 1974, long-term debt amounted to $17,457,000, an increase of $1,362,000 from the $16,095,000 payable at December 31, 1973. Long-term debt consisted of the following:

	1974	1973
	(In Thousands)	
Note payable to bank at ½% above prime, due $250,000 quarterly through 1975 and $500,000 quarterly in 1976 and 1977	$ 4,000	$ 5,000
Note payable to bank at ½% above prime, due in equal quarterly installments from 1976 through 1981	8,000	6,500
Production loan at ½% above prime, due through 1976	2,113	2,090
Other	3,344	2,505
	$17,457	$16,095

The bank loan agreements require, among other things, the maintenance of minimum levels of working capital and net worth and prohibit the payment of cash dividends (waived in 1974) on Reserve's common stock. The prime rate applicable to both bank notes was 10½% at December 31, 1974. The note due in 1981 is part of a line of credit that cannot exceed $10,000,000.

The aggregate amounts of minimum maturities of long-term debt are as follows: 1975—$2,134,000; 1976—$4,455,000; 1977—$4,129,000; 1978—$2,070,000; 1979—$1,736,000; 1980-1984—$3,030,000; and thereafter—$2,037,000.

At December 31, 1974 Reserve and its consolidated subsidiaries were contingently liable under open letters of credit and for indebtedness of affiliates and others of approximately $60,000,000.

Stock-Option Plans. Reserve has several stock-option plans for officers and key employees, approved by stockholders at various times, under which options may be granted at the market price at the date of grant, but are not exercisable until at least one year after date of grant. Options expire five years after date of grant. At December 31, 1973, options were outstanding for 305,298 shares of the Company's common stock and 40,200 shares were

available for the granting of additional options. During 1974, options for 132,000 shares were granted, options for 81,000 shares expired and options for 17,223 shares were cancelled. At December 31, 1974, options were outstanding for 339,075 shares at prices ranging from $9.875 to $4.375 per share, an aggregate of $2,260,597. At that same date options for 207,075 shares were exercisable and 3,000 shares were available for the granting of future options.

In addition, Canadian Reserve has a stock option plan under which options are granted at 90% of market value at date of grant, become exercisable in annual 20% increments beginning one year after date of grant, and expire ten years after the date granted. At December 31, 1974, options were outstanding for 160,400 shares of Canadian Reserve common stock (issued in 1973 and prior), of which 81,300 were exercisable, and 34,700 shares were available for the granting of future options. During 1974, options for 13,600 shares were cancelled. The exercise price on all outstanding options was changed on June 6, 1974 to the market price on that date, $3.20 per share, an aggregate of $513,280.

Capital Stock. Reserve has four series of 5½% cumulative, convertible, voting (except Series C), preferred stock. Shares issued as of December 31, 1974, follow: Series A—23,638, Series B—103,299 (includes 2,558 treasury shares), Series C—9,600 and Series D—173,490. Such shares are convertible into common stock at various rates and are callable by the Company at various times and at amounts up to 106% of par value.

During 1974, 107 shares of preferred stock (623 in 1973) were converted into 192 shares of common stock (1,580 in 1973). At December 31, 1974, 980,073 shares of common stock were reserved for issuance as follows: 637,998 shares for conversion of preferred stock and 342,075 shares in connection with stock options. Warrants for the purchase of 115,652 common shares were acquired by Reserve through the issuance of 3,000 common shares from treasury in 1974.

Capital in Excess of Par Value. In 1974, Canadian Reserve sold, under an employee stock purchase plan, 21,640 shares (10,418 shares in 1973) of its common stock for $21,798 ($10,418 in 1973) and charged $76,000 to expense in 1974 ($54,000 in 1973). As a result, Reserve increased capital in excess of par value by $8,000 in 1974 ($36,000 in 1973). Capital in excess of par value was also increased in 1974 by $2,000 ($14,000 in 1973) as a result of conversions of Reserve preferred stock and decreased by $32,000 upon issuance of common shares from treasury for warrants. Other changes in capital in excess of par value in 1973 were increases of $12,000 as a result of exercise of Canadian Reserve stock options, $254,000 upon issuance of Canadian Reserve shares for interests in oil and gas properties and $509,000 as a result of conversion of Western Crude Oil notes and exercise of Western Crude Oil stock options prior to the April, 1973, merger of Western Crude Oil, Inc., into Reserve.

Company's Stock

Reserve Oil and Gas Company Common Stock is traded on the New York and Pacific Stock Exchanges and is quoted in the Wall Street Journal and in other major newspapers. It was traded on the American Stock Exchange prior to August 12, 1974. Reserve's Preferred Stock (Series A, B and D voting; and Series C, non-voting) is not listed and is infrequently traded in the over-the-counter market. Accurate quotations for these shares are not available. The quarterly ranges of Common Stock trading and dividends paid per share for both Common and Preferred Stock are shown below.

	Common Stock			Pref. Stock (each series)
	High	Low	Dividend	Dividend
1973				
First Quarter	$11.375	$7.875	$ —	$.34375
Second Quarter	9.250	5.625	—	.34375
Third Quarter	8.750	6.000	—	.34375
Fourth Quarter	10.000	6.500	—	.34375
1974				
First Quarter	9.250	6.875	—	.34375
Second Quarter	8.125	6.250	.05	.34375
Third Quarter	6.875	3.750	—	.34375
Fourth Quarter	6.375	4.000	.05	.34375

Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission provides certain additional information and will be available in April. A copy of this report may be obtained free of charge upon request to the Secretary of the Company.

Summary of Accounting Policies

Principles of Consolidation. Accounts of wholly- and majority-owned subsidiaries are consolidated in the accompanying financial statements.

Accounting Changes. The accompanying consolidated financial statements, with respect to 1973, have been restated to reflect the retroactive adoption in May, 1974 by Reserve's Canadian subsidiary of deferred income tax accounting related to drilling and exploration costs in accordance with a March 28, 1974 ruling by the Canadian Provincial Securities Administrator. Prior to this ruling, no deferred taxes were provided on drilling and exploration costs deducted for taxes but capitalized for books.

As a result of this accounting change, Reserve at December 31, 1972 has retroactively reduced minority interest by $460,000 and retained earnings by $4,360,000, increased deferred taxes by $4,491,000 and increased capital in excess of par value by $329,000 (attributable to the minority interest) at that date from that which had been previously reported. The effect of the accounting change also decreased previously reported income before extraordinary credits and net income by $1,565,000 ($.13 per common share) in 1973 and increased (decreased) deferred income taxes, minority interest and shareholders' equity by $6,258,000 ($633,000), and ($5,625,000) respectively, at December 31, 1973.

Reserve elected in December, 1974 to change its method of valuing domestic inventories of purchased crude oil and refined products from average cost to the last-in, first-out method in order to reflect the current cost of conducting its business and to eliminate inventory profit arising from recent increases in petroleum product prices. The effect of this change in 1974 is a reduction in net income of $658,000, equal to $.05 per common share, substantially all of which is applicable to the fourth quarter. The effect of this change, had it been applied retroactively to years prior to 1974, is not determinable.

Foreign Operations. Accounts carried in foreign currencies are translated to U.S.-dollar equivalents as follows: current assets and liabilities at the prevailing rate of exchange at the balance sheet date; non-current assets and liabilities at the rates prevailing when such assets were acquired or liabilities incurred; revenues, costs, and expenses at the average rate during the period. Translation gains or losses (not significant) are included in operating results. The net assets and net income (after adjustments for deferred income taxes) of Reserve's foreign operations and Reserve's equity therein are as follows:

	1974	1973
	(In Thousands)	
Net assets at year end	$36,363	$29,272
Net income	3,205	5,840
Reserve's equity:		
In net assets at year end	33,094	25,428
In net income	2,695	4,730

Land Sales—Residential. Reserve follows the installment method of accounting for its retail sales of residential lots and defers related direct selling expenses and commissions in accordance with provisions of the accounting guide "Accounting for Retail Land Sales" issued by the American Institute of Certified Public Accountants.

Land Sales—Commercial. Reserve records sales of commercial property on the accrual basis of accounting upon receipt of a 20% down payment and execution of a contract. The contract rate of interest charged to commercial land customers is 6%. Reserve has imputed interest on commercial sales contracts at 12%.

Short-Term Investments, consisting of certificates of deposit, bankers' acceptances, commercial paper and government obligations, are carried at cost, which approximates market.

Inventories of crude oil, refined products and sulfur are carried principally at average cost in 1973. This policy has been continued in 1974 except for domestic inventories of purchased crude oil and refined products, which are valued on the last-in, first-out method in 1974. Carrying values in both years are lower than market values; the current cost of inventories at December 31, 1974 exceeds the last-in, first-out cost by $1,266,000. Materials and supplies are carried at or below average cost. Subdivided land is carried at cost, which is less than market. Property taxes and interest relating to subdivided land are expensed as incurred.

Properties. Expenditures for oil and gas exploration in the United States (including geological costs, delay drilling rentals and dry hole costs) are expensed as incurred, and costs of acquiring non-producing mineral rights are capitalized and charged to expense when surrendered. Such expenditures incurred by Canadian Reserve after December 31, 1970 and similar costs in other foreign areas as a whole are separately capitalized and amortized under the full-cost method of accounting.

Depletion and depreciation of the costs of oil and gas properties are computed on the unit-of-production basis except that foreign exploration costs, other than Canadian Reserve's, are amortized over an estimated holding period until economic reserves are established. Buildings and other equipment are depreciated by the straight-line and declining balance methods at rates varying from 2½% to 33⅓% per annum.

Maintenance and repairs are expensed as incurred; renewals and replacements which improve or extend the life of existing properties are capitalized and depreciated. Gain or loss is recognized upon sale or retirement of assets depreciated on the straight-line or declining balance method. For properties depreciated on the unit-of-production method, the cost of the asset sold or retired, less the amount realized, is charged to accumulated depreciation.

Income Taxes. Reserve provides for deferred income taxes applicable to transactions which affect book and taxable income

in different years (principally undistributed earnings of Western European subsidiaries, drilling and exploration costs incurred by Canadian Reserve, depreciation and sales of commercial land reported for income tax purposes on the installment method). No provision for deferred U.S. tax is made for differences of a permanent nature such as those arising from statutory depletion and intangible drilling costs. No provision is made for U.S. income taxes attributable to earnings of Canadian Reserve as it is anticipated that accumulated earnings of $9,222,000 will be permanently invested in Canada.

Investment tax credits of $332,000 in 1974 ($524,000 in 1973) have been accounted for in the year used in accordance with the flow-through method.

The components of income tax expense are as follows:

	1974	1973
	(In Thousands)	
Federal Income Tax		
Current	$ 7,669	$2,423
Deferred	1,651	2,233
Provision offset by extraordinary item	—	2,000
State Income Tax		
Current	973	897
Foreign Income Tax		
Current	157	1,365
Deferred	2,147	1,060
	$12,597	$9,978

Employee Benefit Plans. Reserve adopted a company-wide retirement plan effective in 1973 for the benefit of eligible U.S. employees. 1974 pension expense was $465,000 ($486,000 in 1973), including funding of 10% of prior service cost. Unfunded prior service cost amounted to $2,889,000 at December 31, 1974. It is anticipated that the provisions of the new Employee Retirement Income Security Act of 1974 will not require materially increased Company contributions in future years.

Reserve also has a thrift plan for the benefit of most U.S. employees. Generally, under the plan participants are permitted to contribute from 1% to 5% of regular base pay, and Reserve contributes an amount equal to the aggregate of employee contributions. Reserve may make additional contributions under the provisions of the plan, but has never done so. Reserve's contribution of $231,000 in 1974 ($126,000 in 1973) was charged to operations.

Per-Share Data. Income per share of common stock is based on the weighted average shares outstanding after deduction of preferred dividend requirements. Assuming conversion of outstanding preferred stock and exercise of outstanding stock options and warrants at the beginning of the year, there would have been no dilution of the per-share amounts.

Report of Certified Public Accountants

The Board of Directors and Shareholders
Reserve Oil and Gas Company

We have examined the accompanying consolidated balance sheet of Reserve Oil and Gas Company at December 31, 1974 and 1973 and the related consolidated statements of income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We have previously reported on the consolidated financial statements of Reserve Oil and Gas Company for 1973 under date of February 15, 1974. The accompanying consolidated financial statements for that year have been restated for the retroactive adoption of deferred income tax accounting for Canadian drilling and exploration costs as described in the Summary of Accounting Policies under "Accounting Changes."

In our opinion, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1974 and December 31, 1973 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period after the restatement, which we approve, for the change in accounting discussed above, and except for the change in 1974, which we approve, in the method of accounting for inventories as described in the Summary of Accounting Policies under "Accounting Changes."

Arthur Young & Company

San Francisco, California
February 21, 1975

Consolidated Summary of Operations

(In thousands, except per share amounts)	1974	1973	1972	1971	1970
Revenues	$ 724,721	$ 406,007	$ 259,200	$ 179,442	$ 173,098
Cost of sales and operating expenses	673,895	362,888	235,058	157,996	151,729
Depletion, depreciation and abandonments	7,488	9,187	6,208	5,294	4,962
Interest expense	2,177	1,762	1,366	1,601	2,020
Federal, state and foreign income taxes	12,597	9,978	2,695	1,739	1,750
Income before extraordinary items	$ 13,677	$ 8,768	$ 4,003	$ 3,599	$ 2,953
Extraordinary items	—	2,000	1,224	247	(6,368)
Net income (loss)	$ 13,677	$ 10,768	$ 5,227	$ 3,846	$ (3,415)
Income (loss) attributable to common stock	$ 13,254	$ 10,345	$ 4,803	$ 3,422	$ (3,843)
Per share of common stock:					
Income before extraordinary items	$1.08	$.68	$.30	$.29	$ .24
Extraordinary items	—	.16	.10	.02	(.60)
Income (loss) attributable to common stock	$1.08	$.84	$.40	$.31	$(.36)
Dividends	$ .10	$ —	$ —	$ —	$ —
Weighted average number of common shares outstanding	12,273,000	12,271,000	11,904,000	10,978,000	10,624,000

Results for 1973 and prior years have been restated for two retroactive accounting changes: The adoption in 1974 by Reserve's Canadian subsidiary of deferred income tax accounting related to drilling and exploration costs; and the adoption in 1972 of the installment method of accounting for retail land sales.

Management's Discussion and Analysis of the Consolidated Summary of Operations

1974 vs. 1973

Revenues amounted to $724.7 million in 1974, an increase of 78% over 1973. This increase is due principally to price increases received from the sale of crude oil and petroleum products. Volumes of crude oil and natural gas produced and sold and crude oil purchased and sold, in total, increased slightly in 1974 compared with 1973. The volume of refined and other petroleum products sold increased approximately 37% in 1974. Interest and dividend income increased $1.8 million to $3.9 million in 1974 as a result of higher interest rates prevailing in 1974 and an increase in funds available for investment in short-term instruments. Real estate and other income increased $3.4 million to $8.7 million in 1974 due to an increase of $3.2 million in ship charter income. Cost of sales and operating expense amounted to $673.9 million in 1974, an increase of 86% over 1973. This increase is primarily due to the increased cost of crude oil purchased and also reflects the increased cost of labor, materials and supplies and a 1974 change in method of valuing certain inventories from average cost to the last-in, first-out method. Depletion, depreciation and abandonments amounted to $7.5 million in 1974, down $1.7 million from 1973 due to a $2.1 million write-down of certain oil and gas properties in 1973. Interest expense increased $415,000 to $2.2 million in 1974 as a result of increased interest rates in effect in 1974. Interest-bearing debt balances increased only slightly in 1974. Income tax expense increased $2.6 million to $12.6 million in 1974 due to higher pre-tax income. The tax rate was less than that in 1973 because of increased deductions for intangible drilling costs and allowable depletion. There was no extraordinary credit in 1974 compared with a credit of $2.0 million in 1973 representing tax benefit from federal income tax net operating loss carryforwards.

1973 vs. 1972

Revenues amounted to $406.0 million in 1973, up $146.8 million or 57% from 1972. The principal reasons for this increase were increased prices received from the sale of petroleum products and foreign sales of $49.9 million generated by newly established Western European subsidiaries of Western Crude. Cost of sales and operating expenses increased $127.8 million or 54% due primarily to increased cost of crude oil and other petroleum products purchased for resale. Depletion, depreciation and abandonments increased $3.0 million to $9.2 million in 1973 due principally to a write-down of $2.1 million with respect to certain oil and gas properties. Interest expense increased $396,000 in 1973 to $1.8 million due to higher interest rates. Income taxes increased $7.3 million to $10.0 million in 1973 primarily due to increased pre-tax income. Extraordinary items increased $776,000 in 1973 to $2.0 million as a result of increased federal income tax against which available net operating loss deductions were applied. Extraordinary items in 1972 included a gain of $468,000 (less income tax of $117,000) on the sale of a fertilizer plant.

Prior to 1972

The net loss reported in 1970 of $3,415,000 is attributable to an extraordinary provision for loss on disposition of a fertilizer plant and the loss from the operation thereof in the amount of $6,766,000 and $766,000 respectively, both net of income tax benefits of $584,000 and $651,000, respectively.

Principal Subsidiaries

Canadian Reserve Oil and Gas Ltd.
639-5th Avenue, S.W., Calgary, Alberta T2P OM9, Canada
Paul D. Meadows, President
R. Bruce Bailey, Executive Vice President and General Manager

Mohawk Petroleum Corporation, Inc.
550 South Flower Street, Los Angeles, California 90017
Malcolm McDuffie, President

Western Crude Oil, Inc.
1776 Lincoln Street, Denver, Colorado 80203
Cortlandt S. Dietler, President

Division and Other Offices

Executive Office:
550 South Flower Street, Los Angeles, California 90017
John R. McMillan, Chairman of the Board and Chief Executive Officer
Harold F. Green, Senior Vice President

General Operating Office:
1776 Lincoln Street, Denver, Colorado 80203
Paul D. Meadows, President and Chief Operating Officer

Mid-Continent Division
1806 Fidelity Union Tower, Dallas, Texas 75201
John M. Penrod, Manager

Western Division
1776 Lincoln Street, Denver, Colorado 80203
Robert P. Mangold, Manager of Field Operations

Apple Valley Ranchos Division
P.O. Box 1, Apple Valley, California 92307
Walter E. Cramer, Jr., Vice President

Transfer Agents / Registrars

Security Pacific National Bank
Corporate Trust Division
333 South Hope Street, Los Angeles, California 90017

The Chase Manhattan Bank, N.A.
One Chase Manhattan Plaza, New York, New York 10015

Shareholders and Employees

Shareholders	22,327
Employees	981

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